

Diversification of energy sources: question of questions for Ukraine

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The issue of diversifying Ukraine's energy supply sources have been high on the government's agenda for a long time. Yet, notwithstanding the strategic importance of finding a proper solution to what has been a major economic security challenge, the symbolic "protocol of intentions" has failed to set the deadline clearly.

All governments since Ukraine gained its independent statehood sought to address the issue of diversifying energy supply, but their efforts have proved to be obviously insufficient for meeting the declared objectives. As a result, currently Ukraine is import-dependent for 80 percent of the gas, and 90 percent of the oil it consumes. According to the statement of Prime Minister of Ukraine Victor Yushchenko during his presentation of the "Ukrainian Part of the Eurasian Oil Transportation Corridor" on October 24, 2000, "Ukraine's energy balance is covered with domestically excavated oil by only 10 percent. Therefore, we are determined to find reliable sources of oil supply and ways of diversifying the supply sources (DINAU, October 25, 2000). The other 90 percent of Ukraine's consumption of oil arrive from practically the single source, Russia, though it has been a matter of common knowledge that dependence for more than 30 percent of oil or gas imports from one source is a real challenge to economic independence and, hence, is politically dangerous. Meanwhile, according to Ukrainian Minister of Fuel and Energy Serhiy Yermilov, "the decrease in oil extraction [in Russia] has been observed since 1983" (Uriadovyi Kurrier, October 26, 2000).

The strategic need to diversify the sources of energy supply as a key economic security objective has been repeatedly discussed at the top level of the government. Victor Yushchenko's predecessor in the PM office, Valery Pustovoitenko insisted that the energy supply should be diversified because "this is <...> unnatural if a country is 80 to 90 percent dependent on the single "pipe" (Uriadovyi Kurrier, February 7, 1998). Within Pavlo Lazarenko's term in the PM office, on January 14, 1997, the government approved the "Concept of Diversification of Sources of Gas and Oil Supply to Ukraine" that involved the task "to create the Interdepartmental Coordination Center for diversification of sources of gas and oil supply to Ukraine".

The current government's Program of Action, "Reforms for Well-being", also did not leave out the problems linked to the need to diversify sources of energy supply. The Interdepartmental Coordination Center for diversification of sources of gas and oil supply, with Vice Prime Minister Yulia as its official leader, seemed to have been given a new boost in March 2000, but so far the Center has failed to accomplish the mission it was entrusted.

As history shows, awareness of a strategic objective does not guarantee that it will be pursued consistently and thoroughly. As efforts to carry out the diversification intentions have demonstrated so far, the challenge has never been addressed systemically in Ukraine, i.e., the search for possible solutions has not included EU states that are also interested in diversifying their own energy supply sources, nor has it involved influential oil companies, nor attracted the necessary investments. In September 1997, then secretary of the National Security and Defense Council of Ukraine Volodymyr Horbulin - who then gave a major push to a sequence of steps designed to solve the energy supply problem - stated in one of his articles that "due to the geographic factor Ukraine is able to take an active part in the implementation of EU's "Black Sea interests"; to a large extent, [it] is keeping the keys to Europe's energy security, and is seeking diversification of energy supply not only in its own interests" (Uriadovyi Kurrier, September 4, 1997). The context of the statement was the Eurasian oil transportation corridor, the so-called "Black Baltic Sea Pipeline", the extension of the Baku-Supsa branch by means of tanker supply of oil to Ukraine and pumping the Caspian oil through the territories of Ukraine and Poland. Given the rapid growth of volumes of extraction of oil in the Caspian basin, the idea remains a potentially awarding one.

Efforts to diversify sources of supply of energy and the search for new energy sources started during Leonid Kuchma's premiership. On February 15, 1993, Prime Minister Leonid Kuchma signed the Cabinet's Resolution #104 "On Construction of the Oil Transshipment Complex". The document was approved "in order to create conditions for ensuring reliable supply of Ukraine with oil that will arrive by sea transport." The resolution also provided for building an oil transshipment complex (usually referred to as "terminal") near Odessa that would receive oil, delivered by sea, and supply it further to oil refineries. The complex's target capacity was 40 million tons of crude oil per year. The first section of the complex was expected to start operation in 1994. At that time the intended focus was on transshipment of Middle Eastern oil, but it switched to the Caspian oil later. However, the construction

of the Pivdennyi oil terminal did not start until 1995, and to date only 15 percent of the complex facilities have been actually build. The construction of the first branch of the Odessa-Brody oil pipeline did not begin till 1996, and since then has been challenged by severe lack of funding.

Moreover, the process of construction of the would-be oil transportation route was accompanied with strategically inadequate actions of some government agencies that mismatched the goal of the construction. For instance, the Pustovoitenko government agreed to the transfer of the controlling lot of shares in the Odessa oil refinery to the Russian LukOil company, interested in promoting alternative transportation routes for Caspian oil, the Baku-Novorosiysk-Constanca-Triest line.

So much for the strategic problems of the past - for now. On October 24, 2000, one of Ukraine's longest lasting construction projects, the new oil pipeline Odessa-Brody was solemnly presented in Kyiv. Speaking at the presentation, Prime Minister Victor Yushchenko optimistically announced that the first section of the oil pipeline, capable of transferring 12 million tons per year would be "brought into operation already in 2001" (Molod Ukrainy, October 26, 2000). Hence, according to the Prime Minister, next year the new Ukrainian oil pipeline, Odessa-Brody, may be able to deliver Caspian oil to this country as well as countries of Europe, and will have an impact on the situation at the European fuel market. The market that has repeatedly experienced shocks due to protracted conflicts in supplier states and the unstable political situation in the Middle East. Experts believe that the European countries' demand for oil will continue to grow, and currently the European Union is motivated to diversify its energy sources. While in 2002 the EU states' oil needs is estimated to be 606 million tons, it is expected to grow to at least 655 million tons in a decade.

The introduction of the first section of the new oil transportation pipeline, according to Victor Yushchenko, means balancing Ukraine's domestic oil consumption. Hence, Ukraine, as a transit state, has some chance to help the EU diversify its energy sources while simultaneously meeting its own objectives. The recent conference in Vienna on "Transportation of Oil and Gas in the CIS and the Caspian Region", attended by a number of major financial and business institutions, addressed major pipeline transportation and distribution projects, the "Black Baltic Sea Pipeline" - Baku-Odessa-Brody-Gdansk (via the Druzhba system) being seen as one of the "favorites" of seven options of delivering oil to Europe.

According to a recent report in the Ukrainian government's official publication, a European Commission representative "guaranteed that Ukraine [would be provided with] EURO 15 million for the reconstruction of the Druzhba oil pipeline" (Uriadovyi Kurrier, October 26, 2000). However, it is too early to make final conclusions about EU member states' interest in supporting Ukraine's project. Economic calculations and the tough competition which Ukraine so far has not been able to win play a significant negative role in this state's ability to transform its ambitious intentions into reality. Meanwhile, the initiator of the idea to bypass Ukraine, the Russian Gazprom, has been far more successful in forming an international consortium of major stakeholders in the European energy business, including the Gazprom itself, the German Ruhrgas and Wintershall, the Gas de France and the Italian Snam. According to the Russian party, the need to build the alternative transportation route has been caused by the fact that, according to Russian First Vice Prime Minister Vladimir Khristenko, it is impossible to carry out the joint project "with the existing gas transportation systems". The Vice Prime Minister also referred to Russian President Vladimir Putin who had reportedly ordered "to work on the issue of building the Sukhodolnaya-Rodirnowska oil pipeline, bypassing Ukraine, that would link the Druzhba and the Adria oil pipelines (Ukraina Moloda, October 24, 2000). Hence, while the Ukrainian government in general and its leader in particular are "positive about the prospects for an international consortium for the creation of a Eurasian oil transportation corridor" (ITAR-TASS, October 24, 2000), the Russian party has actually managed to form a powerful "gas consortium". In order to finalize Russian plans it is necessary to persuade Poland to cooperate and allow the construction of an alternative pipeline bypassing Ukraine through the Polish territory.

The Ukrainian part of the Eurasian oil transportation corridor runs by the towns of Kotovsk, Tomashpil, Kamyano Hirka, Zhmerynka, Derazhnya and Shepetivka, and goes to the Polish border. The problem is that there the pipeline ends: the Polish part of the construction has not been linked to the Ukrainian part yet. Hence, so far Ukraine has built a pipeline to nowhere, as, according to what has been described by a major national daily as a "trustworthy source close to the Ministry of Fuel and Energy of Ukraine", so far Poland has demonstrated but "agreement" to take part in building an oil pipeline from Odessa to Western Europe, but no real action (Den, October 26, 2000). Meanwhile, it is estimated that extending the oil pipeline by the additional 280 km from Brody to Polock may allow supplying oil to Poland and Germany.

To date, about 85 percent of the Ukrainian part of the oil pipeline has been completed. Once constructed, the Ukrainian part of the "Black Baltic Sea Pipeline" will allow to transport oil from Azerbaijan and Kazakhstan to oil refineries of Ukraine, Slovakia, the Czech Republic by means of

unused capacity of the Druzhba system. However, on top of other challenges, prospects for finalizing the Ukrainian part of the pipeline seem rather gloomy from the financial point of view. In order to complete the first section of the pipeline, at least UAH 600 million are to have been invested by the end of next year, but no such appropriation has been envisaged by the draft 2001 budget. The Druzhba company that is building the pipeline also does not have the required amount of funds.

A few days after the presentation of the "Eurasian Oil Transportation Corridor", on October 31, President Leonid Kuchma chaired the session of the National Security and Defense Council of Ukraine (NSDCU) that addressed the issue "On urgent measures of activation of Ukraine's involvement in the Eurasian Oil Transportation Corridor". High-ranking participants of the session defined the status of implementation of the NSDCU decision of February 14, 2000, enforced by the President's decree of March 10, "On the Decision of the National Security and Defense Council of Ukraine of February 14, 2000 "On Urgent Measures for Overcoming the Crisis Phenomena in the Fuel and Energy Complex of Ukraine", as "unsatisfactory". Paragraph 27 of the decree demanded "taking urgent measures for accelerating the final stage of construction of the first section of the Pivdennyi oil terminal and the Odessa-Brody oil pipeline." Strong criticism was addressed not only to failing efforts to diversify sources of energy supply and the lack of progress in finalizing the Odessa-Brody pipeline, but also to the level of activities taken to "create external environment for the implementation of the Eurasian oil transportation corridor" (Den, November 2, 2000). Meanwhile, presenting the new oil pipeline project Prime Minister Yushchenko announced: "We would like to see, in the role of implementators of this project, both foreign investors with world-known names and Ukrainian domestic companies. However, we should understand that Ukraine gets into the system of preferences. If today we fail to demonstrate an effective European policy in this sphere, much of the negative [information] that has been in the focus of discussion these days may become true <...> nowadays it is necessary to pay maximum attention to the negotiation process and find harmony in this part of relations with the EU" (Ukraina Moloda, October 25, 2000). So far Ukraine has not been EU's favorite choice. As instability in the Middle East push oil prices up, the European Union member states are trying to diversify their energy supply sources and are increasingly keen on taking Russia's offer. European Commission President Romano Prodi has spoken in favor of entering a long-term natural gas supply agreement with the Russian Federation. After the EU-Russia Paris summit on October 31, 2000, Mr. Prodi announced that a working group would be formed to analyze possibilities for importing Russian energy sources in exchange for Western investment into its infrastructure. Reportedly, one of the members of the recent Moscow agreement on construction of a gas pipeline from the Yamal peninsula to Europe, Gaz de France, have already started making budget estimates for building a gas pipeline bypassing Ukraine. The current political and economic trends develop rather unfavorably for Ukraine, making it difficult for it to meet its ambitious objectives involving the new pipeline. The time factor is also not working in favor of Ukraine. So far the country's rather strong strategic potential have not been used in full, as the National Security and Defense Council admits. The NSDCU's recent session blamed the government for the failure to develop a complex solution that would involve foreign policy and foreign economic steps to promote the Eurasian oil transportation corridor idea. Specifically, the government was criticized for not engaging in "negotiations with countries and major companies involved in oil extraction and trading in Caspian oil: Chevron, British Petroleum, Exxon - Mobil, etc. The Ukrainian party limited itself to discussions and presentations; as a result no major company showed any interest in the Ukrainian part of the oil transportation corridor" (Den, November 2, 2000).

The NSDCU session emphasized that Ukraine occupied a "strategically important geographic position on the way of the optimal energy flows" and, therefore, "must substantially benefit from the current situation of dynamic re-division of the energy supply structure in the European geo-economic environment" (DINAU, October 31, 2000). Commenting on the problems related to the new oil terminal, NSDCU secretary Yevhen Marchuk announced that "in order to remove the drawbacks, a coordinating agency may be established, to be chaired by a special representative of the President, possibly, in the rank of the special envoy, which characterizes the importance given to this dimension by the Ukrainian leadership. Special groups of diplomats will be formed in Ukraine's embassies to relevant countries" (Den, November 2, 2000).

The NSDCU session proceeded to propose a number of economic and political steps designed to enhance Ukraine's bid for taking part in the Eurasian oil transportation corridor. Among other things, the government was ordered to decide on relevant sources of funding and initiate an international consortium that would carry out the project of developing the Ukrainian part of the corridor. The proposals included amending the relevant bills in order to create economically favorable conditions for investment in the project and for prevention of possible environmental hazards that may be caused by operation of the Ukrainian section of the Eurasian oil transportation corridor.

Yet, notwithstanding Ukraine's attractive location and transit potential, implementation of the transportation corridor project currently offers an increasing number of questions that require coherent answers and solutions. Otherwise Ukraine risks to be simply left out to enjoy its "important geostrategic geographic location", the pipeline to nowhere and the much-suffered "multi-vector approach".